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SPECIAL REPORT

BREAKING UP THE PHONE COMPANY

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James Rosenquist's cover painting takes as its theme the pulling apart of Ma Bell's empire. A comprehensive special report on what the epochal AT&T breakup will mean for the newly created companies, competitors, investors, and phone customers begins on page 60.

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WANT TO BUY A JAPANESE COMPANY?

■ For a Japanese to sell his company to a foreigner used to be not only an enormous legal hassle but also a departure from good form akin to strangling one's children. In recent years the Japanese government has cut some of the red tape, and in certain circumstances selling a company to foreigners is now seen not as horrible, simply regrettable. With the loosened rules, a few foreign firms have found a quick—though not necessarily painless—way to squeeze into the Japanese market.

The opening is just a crack for now, but it's getting wider. In the decade from the mid-Fifties to the mid-Sixties only two companies were sold to foreigners, according to a survey by Bain & Co., a Boston management consulting group. Recently the pace has quickened to the rate of about two or three a year, bringing the total to 20. Foreigners have also bought substantial shares in 30 additional companies. (For a table showing the foreign stake in the ten largest Japanese industrial companies, see page 109.) The number of deals that have been consummated is few so far, but interest is rising rapidly. When Bain gave a show for Tokyo's American Chamber of Commerce in late May on how to acquire a Japanese company, 140 businessmen attended, twice the usual number at chamber programs.

MAKING MONEY in Japan may be less important to some outsiders than the chance to see how the Japanese do things at home, so as to compete with them better elsewhere. "If you want to know what's going on in Japanese technology, you've got to get into the business here, hands-on," maintains James C. Abegglen, a vice president in the Boston Consulting Group's Tokyo office. "You can't do it with just a listening post."

Foreign companies going it alone have scored some great successes. IBM of Japan, entirely owned by the American parent, earned $149 million last year, placing it among the most profitable dozen or so companies in Japan. But acquisitions have become more attractive for Americans because the strength of the dollar makes buying a Japanese company these days a relative bargain. Also, the traditional alternatives, such as tossing in with a Japanese company in a joint venture or starting from scratch, have lost some appeal. Many joint ventures have come apart at the seams, among them International Harvester's partnership with Komatsu and Dow Chemical's alliance with Asahi Chemical Industry. . ıd building from the ground up is extremely expensive.

West Joins East *at Kyoritsu Pharmaceutical.*

Although taking over a Japanese company may be a relatively fast and cheap way to get into the market, big and healthy companies are not available. (Japanese slang for unfriendly takeover is *nottori*, which also means hijacking.) Anyone trying to make a tender offer for a major company would be unlikely to pry enough shares free to get control, even if the government allowed him to try (see box, page 108). Most shares of companies listed on the Tokyo Stock Exchange are owned by other companies, often

At a quarterly meeting *in Tokyo, Toho President Motomichi Susai (left) meets with the bosses from Pennsylvania: Rorer International Vice President James J. Martin, Senior Vice President Arthur H. Hackendahl, and President Robert E. Cawthorn. At right is Masahiro Kasagi, president of Systems International, which arranged Rorer's purchase of Toho.*

one another's customers and suppliers, and would be voted to maintain Japanese control.

Even a sick big company is out of reach. It is kept afloat by banks and other companies in its industrial group, or in the worst cases is taken over by another Japanese corporation, as the struggling camera maker Yashica was recently acquired by the industrial-ceramics manufacturer Kyocera. "Getting taken over by a U.S. company would be about tenth on the list of choices for a big Japanese company in trouble," says William N. Horton, a vice president in Goldman Sachs's Tokyo office.

In the U.S. an entrepreneur sells his small successful company to turn his assets into cash or because his heir would rather run an art gallery than a machine shop. In Japan companies are regarded as families—aggregates of people. To sell one is peculiar and to sell one to foreigners who do not hesitate to turn people out on the streets if that suits the owner's purpose is deplorable.

What is left for the foreign shopper, therefore, is mostly the small failures, companies that are either bankrupt already or whose sales and earnings projections curve ever downward. Three-quarters of the companies foreigners have purchased, says Bain, were also-rans in slow-growing industries, a category that consultants' lingo and common parlance alike call dogs. Among the canines Bain places Shibazaki Seisakusho, a bottle cap manufacturer of which Alcoa bought 50.5% for $2.5 million in 1979; Sunpole, a maker of household cleaning products taken over by Clorox for something under $5 million in 1981; and Tokyo Ryuki Seizo Kabushiki Kaisha, a drilling equipment manufacturer that Ingersoll-Rand bought for $1 million in 1975.

Money and technology can sometimes turn dogs into more ferocious beasts, which is why buyers are willing to take a chance on them. To serve such customers, a pet shop is likely to appear. Tokyo's is Systems International, a small firm that has been advising outsiders on joint ventures and licensing for 13 years, and for the past five on acquisitions as well. Systems' founder and chairman is T. Yoshitami Arai, 52, who started Japan's first trading stamp company. The firm's senior adviser is Donald P. Knode, 59, who went to Japan as a young U.S. Navy officer with the grim job of helping to assess the destruction at Hiroshima. In 1970 he opened Merrill Lynch's Tokyo branch.

What Systems offers clients is contacts and a knowledge of traditions. "You can't call up someone cold in this country and say, 'I want to buy your company,' " he observes. "When the Japanese National Railways wanted to buy up land for a right-of-way, it sent representatives out with bottles of sake to call on each property owner individually. That's the way things are done here."

IN NEGOTIATIONS, the heart of the matter—that ownership is going to change hands—is approached gradually and indirectly. "At first the Japanese owner can't accept the fact that he is selling his company," says Knode, "and so we talk about the foreign company taking a percentage of equity."

Even though the powerful dollar seems to buy a lot in Japan these days, Japanese companies tend to be overpriced by American standards. Companies traded on the Tokyo Stock Exchange currently sell for slightly

SILK'S NO BUSINESS FOR OUTSIDERS

■ In principle a foreign shopper can buy any Japanese company that catches his eye. In practice the Japanese government reserves the right to limit foreign ownership where outside control might imperil national security or interfere with the smooth operation of the economy. It is perhaps understandable why the government put half a dozen oil companies and a couple of defense contractors on the restricted list. Maybe a case can also be made that the government was being properly cautious in including Sankyo, a major pharmaceutical manufacturer. But why Katakura Industries? Katakura's supposedly strategic product is silk.

Tseng Hsiang Wang, 57, a Chinese who spent the war years in Japan selling fish to the army, is chairman of Newpis Hong Kong Ltd., an investment company that owns 10% of Katakura, worth about $6.8 million at recent stock prices. Katakura was once a redoubtable name in commerce, but recently the silk business has declined and Katakura barely ekes out a profit. Last year it earned only $1.5 million on sales of $224 million. A big share of those revenues, $6.4 million in 1982, goes to pay interest on its huge debt, especially to Fuji Bank, Japan's fourth-largest bank and a member of one of Japan's most powerful industrial groups.

What Katakura has going for it is valuable land, such as more than 40 acres around its idle plant in the Tokyo suburb of Omiya. Several years ago Wang suggested that Katakura sell or lease the Omiya land for apartment buildings and reduce the debt to Fuji. Management disagreed. But management might have found it difficult to be objective. Fuji, too, owns 10% of Katakura.

Even more important, the chairman of Katakura Industries, Tadashi Arita, 67, worked for Fuji before taking over Katakura. So had his two predecessors. Arita wanted to rent the Omiya land to Ito-Yokado, a chain of retail stores selling everything from food to hardware. Yokado is another Katakura shareholder, although a minor one, and a customer of Fuji Bank.

Maintaining that the income from apartments would be much greater than from a supermarket, Wang decided to increase Newpis's holdings of Katakura and make management do it his way. But when he routinely filed an application telling the government of his intentions, the word came back that it was out of the question. The silk and cocoon division of the Ministry of Agriculture, Forestry, and Fisheries had ruled that "the production of silk cocoons is essential to the Japanese economy." Foreign ownership of Katakura Industries, therefore, was capped at 25%. Newpis's share combined with that of other foreigners was just a thread below 25% already, and Wang could buy no more.

It is true that most Japanese women must have at least one silk kimono, but it is hard to see how foreign control of Katakura would ravel their wardrobes, especially since Katakura accounts for less than 15% of Japan's silk production. Wang has sued Katakura's management for fiduciary irresponsibility and the Japanese government for violating its own rules as well as its agreements with other nations to open its doors to investment. The courts will decide—but probably not for a year or two—whether the time has come to turn the strategic silkworm over to an outsider.

Hong Kong businessman *Tseng Hsiang Wang has been barred by Japan's government from buying a silk company.*

over two times book value, compared with 1½ for Standard & Poor's 400 industrial companies. Owners of private companies expect similar prices. "If the financial guys back in the U.S. are going to be hardheaded," says Knode, "the deal isn't going to work." But, most important, the sellers want guarantees that they and their people are not going to be dismissed.

Systems' success has been modest to date: three acquisitions, including two for the same client, Rorer Group of Fort Washington, Pennsylvania. Rorer, a pharmaceutical company with sales of about $400 million last year, had long been present in Japan by proxy. Its best-known product, the antacid Maalox, is made under license by a Japanese company. Six years ago Rorer decided to come out of the shadows and plunge in. "We want to become a first-division company and you can't do that without being in the world's second-biggest pharmaceutical market," says James J. Martin, 49, vice president for Far East operations.

Rorer had at least one thing going for it: the Japanese drug industry, or at least part of it, was in terrible shape. In Japan doctors not only prescribe drugs, they buy them from wholesalers at low prices and sell them to patients who pay what they can. Then the doctors get additional reimbursement from the national health insurance program. The markup on the drugs is a major source of doctors' income. To keep health costs in line, the government has been hammering down the amounts that will be reimbursed, and the manufacturers have been under enormous pressure to cut the prices they charge doctors. The blows have fallen hardest on producers with the thinnest margins—small manufacturers of generic, as distinct from brand-name, drugs.

EVEN THOUGH his tiny company faced almost certain annihilation in a decade or so, Masahiro Yamazaki, president of Kyoritsu Pharmaceutical Industries, did not jump at the chance to be the first in his industry bought out by Americans. The company had been founded by his father. "I thought about it by myself for six months," says Yamazaki, 46. "Then I told the other executives and we all thought about it for another six months." In 1979 they started selling all but 2% of their shares to Rorer for $2.7 million in cash. The previous year Kyoritsu's sales had been $3.7 million.

In 1981 Rorer approached Toho Laboratories, a company whose prospects were similar to Kyoritsu's. "Two others were looking at us," says President Motomichi Susai, 46, "a French company and another American.

The French decided to set up their own business and the other American company wanted to be too drastic. They wanted 100% of our shares right away. We liked Rorer. They invited us to Pennsylvania to talk." Last year Susai and his family traded 72% of Toho Laboratories' stock for about $4 million in Rorer shares.

When Yamazaki and Susai proposed the American takeovers to their staffs, among the questions that popped up immediately were: Would promotions be based upon fluency in English? Could they look forward to working American hours? (Like many Japanese workers, they put in a six-day week.) Executives at Kyoritsu rushed out to buy a copy of a newly pertinent reference work, *A Wage Survey of Foreign Capital Affiliated Enterprises in Japan*. But what worried them most was whether the new owners would lay off managers and workers in tough times.

SO FAR LITTLE has changed at either company. Japanese is still the primary company language, and no American-style cutbacks have come to pass. Neither have American-style hours and salaries. Yamazaki and Susai say they continue to run their companies, now subsidiaries, with little interference from Fort Washington. At Kyoritsu Pharmaceutical Industries one of the few signs that the Yanks have landed is that the quality-control circles, perhaps in anticipation of the quarterly visit from headquarters, have strung banners with such slogans as "A waste of a minute costs us 40 yen" in both Japanese and English.

Rorer says that it is satisfied with its Japanese purchases. The generic drug trade has deteriorated further as the Japanese government continues to squeeze prices. But Rorer didn't buy Kyoritsu and Toho only for their existing businesses. It is transforming them into subsidiaries that will test, develop, manufacture, and distribute new Rorer drugs. Because it takes about five years to get a new drug approved and introduced in Japan, it will be a while before Rorer can tell whether its venture is a success.

What Rorer could come to regret is that although it has bought two companies and therefore appears to enjoy all the privileges that come with ownership, in one important respect it has not bought control. If it should lose faith in the local management—even though there is no reason to think that it should—Rorer would be hard pressed to find replacements. The tradition of lifetime employment makes it difficult not only to fire old employees but also to find new ones. "You don't get a guy in his 50s to leave the company he's grown up in to come run yours," says Abegglen of Boston Consulting.

For that matter, the Japanese could find that those safe Rorer hands they placed themselves in aren't so secure after all. What happens if Rorer is swallowed by someone who doesn't think the company belongs in Japan? Susai of Toho says he doesn't worry about things he can't control. "When a young man and a young woman get married," he observes, "they don't think about how they might change in the future."

■ Enthusiasm for acquisitions will almost certainly grow as more foreign companies try to find a way into the Japanese market and as more Japanese who have been battered in that market look for a way out. But not all potential foreign buyers insist on full or even majority ownership; some will settle for a substantial minority share. That makes sense. A Japanese owner whose company is troubled but not exactly a dying dog might be willing to give up part, though not all, of his company to a foreigner with the resources he needs. So in settling for less than full ownership, the foreign shopper gets to pick among better-looking animals. ■

The Foreign Stake in Japan's Top Ten Industrials

Rank	Company Industry	Foreign share
1	Nissan Motor Motor vehicles and parts	8.5%
2	Matsushita Electric Industrial Electronics, appliances	17.0%
3	Toyota Motor Motor vehicles	1.2%
4	Hitachi Electronics, appliances	19.6%
5	Nippon Steel Metal manufacturing	5.0%
6	Mitsubishi Heavy Industries Motor vehicles, industrial equipment	6.8%
7	Idemitsu Kosan Petroleum	0 %
8	Toshiba Electronics, appliances	16.7%
9	Honda Motor Motor vehicles and parts	8.7%
10	Maruzen Oil Petroleum	1.5%

Foreigners are free *to buy into even the most important Japanese companies, but when any foreign entity wants to increase its holdings above 10% it must notify the government. The only one of the ten largest Japanese industrials in which a single foreign investor has a substantial share is Toshiba, 7.7% of which is owned by General Electric. GE not only has half the foreign share in its competitor but also a larger share than any one Japanese investor.*